IN THE

Supreme Court of the United States

OCTOBER TERM, 1959

No. ~~949~~ 14

WM. G. LEWIS, Trustee,
Petitioner,
vs.
MANUFACTURERS NATIONAL BANK
OF DETROIT,
Respondent

BRIEF OF RESPONDENT IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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To the Honorable Chief Justice and Associate Justices of the Supreme Court of the United States:

Respondent prays that the Petition for a Writ of Certiorari to review a judgment of the United States Court of Appeals for the Sixth Circuit, entered in the above cause on March 7, 1960, be denied.

COUNTER-STATEMENT OF QUESTION PRESENTED FOR REVIEW

Respondent contends that the statement of question presented for review as set forth in the Petition on page 2 is insufficient and that the precise legal question considered by the Sixth Circuit Court of Appeals may be more properly stated as follows:

> DOES SECTION 70c OF THE BANKRUPTCY ACT INVEST THE TRUSTEE WITH THE STATUS OF A FICTIONAL CREDITOR EXTENDING CREDIT AT ANY ADVANTAGEOUS TIME DURING AN UNLIMITED PERIOD PRIOR TO DATE OF BANKRUPTCY WITH THE RESULT THAT THE TRUSTEE CAN AVOID A MICHIGAN CHATTEL MORTGAGE FILED OVER FIVE (5) MONTHS PRIOR TO DATE OF BANKRUPTCY WHEN MICHIGAN LAW (NOW NO LONGER IN EFFECT) MADE SUCH MORTGAGE VOID AS AGAINST A SIMPLE CONTRACT CREDITOR EXTENDING CREDIT BETWEEN DATE OF EXECUTION AND DATE OF RECORDING THE MORTGAGE?

REASONS FOR DENYING THE WRIT

Petitioner invokes this Court's discretion by asserting a serious conflict between appellate courts on a question of national importance. Respondent will demonstrate that no serious conflict and no problem of national importance here exist.

The asserted conflict results from the Sixth Circuit's rejection in the instant case (hereinafter called *Lewis*) of a theory advanced in 1954 by the Second Circuit Court of Appeals in *Constance v. Harvey*[1] (hereinafter called *Con-*

[1] (2nd Cir., 1954) 215 F. 2d 571, cert. den. 348 U. S. 913, 75 S. Ct. 294.

stance). The *Constance* theory has generated nothing but criticism and rejection within the Second Circuit and elsewhere. The opinion in *Constance* and the subsequent critical treatment thereof clearly show that the theory was not fully considered and, if it still retains any vitality, it is as a localized, unfortunate deviation from the Congressional intent. Indeed, even Petitioner does not indicate any substantial disagreement with the Sixth Circuit's rejection of the *Constance* theory.

The question presented, far from having national dimensions and recurrent interest, has only a limited geographical basis and may be expected to arise only occasionally in unusual factual situations involving a lack of diligence by the secured lender.

In short, the question submitted may have great interest for the Petitioner and may have some lingering place in scholarly works on the Bankruptcy Act, but does not warrant this Court's attention in view of the press of more serious business. *Rice v. Sioux City Memorial Park Cemetery* (1955), 349 U. S. 70, 75 S. Ct. 614.

I. The Nature of the Conflict

The Sixth Circuit's holding in *Lewis* that a trustee's status under Section 70c accrues *for all purposes* at the date of bankruptcy is hardly novel doctrine, for it merely represents an application of the general principle unanimously announced by this Court in *Bailey v. Baker Ice Machine Company*, 239 U. S. 268, 275-76, 36 S. Ct. 50, 54 (1915), where the Court stated with reference to the statutory predecessor of Section 70c:

> "Although otherwise explicit, this provision does not designate the time as of which the trustee is to be regarded as having acquired the status indicated,

> and yet some point of time must be intended. Is it the date of the trustee's appointment, the filing of the petition in bankruptcy, or some time anterior to both? *When not otherwise specially provided, the rights, remedies, and powers of the trustee are determined with reference to the conditions existing when the petition is filed.* It is then that the bankruptcy proceeding is initiated, that the hands of the bankrupt and of his creditors are stayed, and that his estate passes actually or potentially into the control of the bankruptcy court. • • • Had it been intended that the trustee should take the status of a creditor holding a lien by legal or equitable process as of a time anterior to the initiation of the bankruptcy proceeding, it seems reasonable to believe that some expression of that intention would have been embodied in §47a as amended. As this was not done, *we think the better view, and one which accords with other provisions of the act, is that the trustee takes the status of such a creditor as of the time when the petition in bankruptcy is filed.* Here the petition was filed almost two months after the contract was filed for record, and therefore the trustee was not entitled to assail it under the recording law of the state." (Emphasis supplied.)

This decision, of course, construed Section 47(a) of the Bankruptcy Act as it stood after the 1910 amendment, but the subsequent history resulting in the present language of Section 70c is a chronicle of Congressional confirmation of this Court's opinion in *Bailey*, as demonstrated in the comment on the genesis of present Section 70c annexed hereto as an Appendix.

The conflict which concerns Petitioner arises from the Sixth Circuit's rejection of a theory expressed in *Constance*. In that case, the Court held that Section 70c permitted a trustee to set aside a mortgage properly of record for over one year prior to bankruptcy because such mortgage

had not been filed within a reasonable time after execution as required by New York law and, therefore, would have been vulnerable to attack by a creditor who extended credit between the date the mortgage was executed and the date it was recorded. No such creditor existed at date of bankruptcy, but the Court stated that Section 70c permitted the trustee to avoid the mortgage as a *fictional creditor* extending credit at a time over a year prior to bankruptcy.

Nowhere in its opinion does the Second Circuit Court of Appeals consider the statutory history of Section 70c or available expressions of Congressional intent. Nowhere does that Court display any awareness that its construction of Section 70c creates disharmonies in the Bankruptcy Act. Apparently, the decision was reached only by a literal construction of the language of 70c (as amended in 1952). The only case precedent cited by the Court, *Hoffman v. Cream-O-Products,* 180 F. 2d 649, cert. den., 340 U. S. 815, 71 S. Ct. 44, is completely irrelevant since the security interest there under review was never properly recorded and the trustee clearly had status at date of bankruptcy to set it aside.

Subsequently, in *Conti v. Volper,* 229 F. 2d 317, the Second Circuit reiterated the *Constance* theory in a decision, the full text of which follows:

> "*Constance v. Harvey,* 2 Cir., 1954, 215 F. 2d 571, reluctantly followed by Judge Byers, *may seem to reach an inequitable result,* but Section 70, sub. c, of the Bankruptcy Act, 11 U. S. C. A. §110, sub. c, provides: 'The trustee, as to all property, whether or not coming into possession or control of the court, upon which a creditor of the bankrupt could have obtained a lien by legal or equitable proceedings at the date of bankruptcy, shall be deemed vested as of such date with all the rights, remedies, and powers of a creditor then holding a lien thereon by such

proceedings, whether or not such a creditor actually exists'; and it is difficult to see how such *plain language* could be disregarded.

Affirmed." (Emphasis supplied.)

It is noteworthy that the Court recognized that its theory produces inequitable results, but apparently again felt bound by the "plain language" of Section 70c.

Other courts considering the "plain language" of Section 70c have found its meaning plainly contrary to this Second Circuit theory. In addition to the Sixth Circuit decision in *Lewis*, a District Court of the Eighth Circuit has rejected *Constance*,[2] the Fifth Circuit Court of Appeals has indicated a similar disposition[3] and even in the Second Circuit, at least one District Court has found it possible to evade the *Constance* doctrine by regarding that decision as merely an application of New York law rather than a controlling pronouncement as to the meaning of Section 70c.[4]

In short, the competing interpretation of Section 70c advanced by the Second Circuit has been confined to the Second Circuit and the severe criticism which *Constance* generated makes it highly doubtful that the decision will be accepted elsewhere.[5]

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[2] *In Re Billings* (W. D. Mo., 1959) 170 F. Supp. 253.

[3] *Blackford v. Commercial Credit Corporation*, (5th Cir., 1959) 263 F. 2d 97, Note 14 at pages 111 and 112.

[4] *In Re American Textile Printers Co.*, (D. C. N. J., 1957) 152 F. Supp. 901.

[5] The considerable critical literature is collected in a comment in 57 Michigan Law Review, 1227 (June, 1959); see also the criticism by the House Judiciary Committee in House Report 745 on H. R. 7242, 86th Congress, First Session (1959) where the *Constance* theory is branded as "statutorily unwarranted".

Apart from the evident failure of the "plain language" to support the *Constance* theory; and the fact that no evidence of Congressional intent lends credence thereto, the real anomalies created in the Bankruptcy Act by such theory underscore its insubstantiality.

The *Constance* theory renders Section 70e mere surplusage. Further, and perhaps more important, it runs counter to Congressional recognition that there must be some repose in transactions prior to bankruptcy. Even a transfer in fraud of creditors is unassailable after one year;[6] even a preference is unassailable after four months;[7] but the *Constance* theory would permit the trustee to rummage an unlimited period prior to bankruptcy in search of advantage as a fictional lender. Placed in the context of the Bankruptcy Act and Congressional policy, the *Constance* theory is revealed as no more than an incongruity.

II. The Conflict has neither National Importance nor General Commercial Importance

Petitioner states that the question submitted involves the "extremely important commercial states" of Michigan, New York, Illinois and California. These states may be commercially important, but Petitioner has lost sight of the distinction between a problem which *can* arise in a major commercial state and a problem of recurrent concern in the commerce of such state.

The decision in *Lewis* has put an end to what might have been a serious problem in Michigan prior to 1960. The Michigan legislature, by Public Act 110 of 1959,[8] effective

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[6] Section 67(d), Bankruptcy Act, 11 U. S. C. A. Section 107(d).

[7] Section 60, Bankruptcy Act, 11 U. S. C. A. Section 96.

[8] Mich. Stat. Ann., Section 26.929 (1959 Cum. Supp.).

March 19, 1960, has created a ~~20~~ 10 day grace period for filing chattel mortgages. Accordingly, a reasonably diligent mortgagee can now obtain a valid chattel mortgage lien which is insulated even against the rejected *Constance* theory.

Even in New York the *Constance* theory creates a problem only where a mortgage is not filed within a reasonable time after its execution and thus diligent mortgagees in New York preclude the impact of the *Constance* mischief.

In Illinois, there is a specific statutory grace period of 20 days for filing chattel mortgages[9] and, accordingly, not even great diligence is necessary there to immunize the mortgage from the *Constance* theory.

California law does not require instantaneous recording of the chattel mortgage, but does require recording as soon as practicable. The only Federal case cited by Petitioner involving California law[10] dealt with a 79-day delay between execution and recording and the holding therein may be more properly read as an application of Section 70e of the Bankruptcy Act where actual interim creditors existed rather than an application of Section 70c. The *Constance* theory would become of interest in California only if such questionable doctrine is subsequently espoused by the federal courts in the Ninth Circuit. With the *Lewis* precedent established, and in view of the inherent defects in the *Constance* theory, it would seem that federal courts applying California law would hardly be troubled by the existence of *Constance*, a case without statutory pedigree or judicial precedent.

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[9] Ill. Anno. Stat., Chap. 95, Section 4 (1959 Ann. Cum. Pocket Part).

[10] *Miller v. Sulmeyer*, (9th Cir., 1959) 263 F. 2d 513, *cert. den.* 361 U. S. 838, 80 S. Ct. 55.

CONCLUSION

For the foregoing reasons, Respondent prays that the Petition for Writ of Certiorari be denied.

Respectfully submitted,

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Dated: June 13, 1960.

APPENDIX

HISTORICAL DEVELOPMENT OF SECTION 70(c)

Congress in the 1910 amendment to the Bankruptcy Act vested the trustee with all of the lien rights which any creditor could have acquired under state law as of the date of bankruptcy. The language of Section 47(a)(2) (considered by this Court in *Bailey v. Baker Ice Machine Company*, 239 U. S. 268, 36 S. Ct. 50, 1915) was as follows:

> "Trustees shall respectively: * * * (2) Collect and reduce to money the property of the estates for which they are trustees, under the direction of the court, and close up the estate as expeditiously as is compatible with the best interests of the parties in interest; and such trustees, as to all property in the custody or coming into the custody of the bankruptcy court, shall be deemed vested with all the rights, remedies, and powers of a creditor holding a lien by legal or equitable proceedings thereon; and also, as to all property not in the custody of the bankruptcy court, shall be deemed vested with all the rights, remedies, and powers of a judgment creditor holding an execution duly returned unsatisfied. * * *"

The Chandler Act of 1938 retained the substance of amended Section 47a(2) with some minor changes in phraseology, but shifted the section to become Section 70(c). The 1938 version of Section 70(c), leaving out the first sentence which is not pertinent, read:

> "* * * The trustee, as to all property in the possession or under the control of the bankrupt at the date of bankruptcy or otherwise coming into the possession of the bankruptcy court, shall be deemed vested as of the date of bankruptcy with all the rights, remedies,

and powersof a creditor then holding a lien thereon by legal or equitable proceedings, whether or not such a creditor acually exists; and, as to all other property, the trusteeshall be deemed vested as of the date of bankruptcy with all the rights, remedies, and powers of a judgment creditor then holding an execution duly returned unsatisfied, whether or not such a creditor actually exists."

That is the way this section stood until the 1950 amendment. The 1950 version of Section 70(c), again leaving out the first sentence which is not applicable, read:

"* * * The trustee, as to all property of the bankrupt at thedate of bankruptcy, whether or not coming into possession or control of the court, shall be vested as of the date of bankruptcy with all the rights, remedies, and powers of a creditor then holding a lien thereon by legal or equitable proceedings, whether or not such a creditor actually exists."

In the 1950 anendment to Section 70(c), the distinction between propery in the possession of the bankrupt, and thus coming into the possession of the Bankruptcy Court at the date of bankruptcy, and prope y not so in possession was abolisled. The trustee was given the status of a creditor holding a lien through legal or equitable proceedings as to both types of property, that is, whether in the possession of the Bankruptcy Court or not. The reference to the power of the trustee as a judgment creditor with an execution duly returned unsatisfied was thus deleted as no longer necessary.

The 1952 amendment to Section 70(c) of the Bankruptcy Act made no substantial change. It merely clarified the section so as to eliminate the incongruity of the trustee having a lien onthe bankrupt's property. As stated in the House Report on the 1952 amendment:

"* * * Iowever it is now recognized that the 1950 amendment did not accurately express what was intended. Since the trustee already has title to all of

the bankrupt's property, it is not proper to say that he has the rights of a lien creditor upon property in which the bankrupt has an interest or as to which the bankrupt may be the ostensible owner. Accordingly, the language of Section 70(c) has been revised so as to clarify its meaning and state more accurately what is intended." House Report No. 2320 on S. 2234, 82d Cong., 2d Sess. (1952) 16.

Section 70(c) of the Bankruptcy Act as it now stands, reads as follows:

"• • • The trustee, as to all property, whether or not coming into possession or control of the court, upon which a creditor of the bankrupt could have obtained a lien by legal or equitable proceedings at the date of bankruptcy, shall be deemed vested as of such date with all the rights, remedies, and powers of a creditor then holding a lien thereon by such proceedings, whether or not such a creditor actually exists."

The most recent expression of Congressional intent may be found in House Report 745, Committee on Judiciary, 86th Congress, First Session, quoted extensively in the Sixth Circuit opinion here under review, which states in pertinent part:

"From 1910 to 1954 it was assumed that the rights of the trustee under 70e accrue as of the date of bankruptcy and no earlier. However, in Constance v. Harvey (215 F. 2d 575 (2d Cir., 1954), cert. denied 346 U. S. 913 (1955)), it was held that under Section 70e a trustee has the rights of an ideal hypothetical creditor who has acquired his claim prior to bankruptcy. • • •

The rights of a trustee under 70e are entirely derivative and dependent upon the existence of an actual creditor against whom the transfer might have been invalidated in the absence of bankruptcy. Those rights relate back to whatever date they first arose. Section 70e, on the other hand, gives the trustee the

status of a hypothetical judicial lien creditor whose rights arise as of the date of bankruptcy.

• • • The holding in Constance v. Harvey by injecting into Section 70c the substance of 70e, created the statutorily unwarranted status of a hypothetical creditor with rights relating back to a date prior to bankruptcy. While bankruptcy is in effect a general levy on the property of the bankrupt for the benefit of his creditors, it is not a license for the trustee, irrespective of prejudice to creditors, to avoid at will any security given by the bankrupt which remained imperfected for any period of time prior to bankruptcy. Yet this is the effect of Constance v. Harvey. Under this decision the only limit to the power of the trustee is his ability to conceive of some right of a creditor that can be used as a basis for striking down imperfect transfers. The doctrine of Constance v. Harvey presents a very real threat to security transactions, the validity of which have hitherto not been subject to challenge under the Act. • • •"